Spending Policies for Foundations

The Case for Increased Grants Payout

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National Network of Grantmakers

The National Network of Grantmakers (NNG) was founded in 1980 as an association of individual funders committed to social and economic justice.

Today NNG works primarily within organized philanthropy to increase financial and other resources to groups committed to addressing growing hunger, poverty, homelessness, environmental degradation and other economic and social ills in the United States and around the world, and to empower and support people and organizations whose voices have been traditionally unheard in the democratic process. Membership in NNG includes over 400 individuals who are donors, staff and trustees of family, private and public foundations, philanthropic reform or grantmaking support associations as well as philanthropic consultants, including donor organizers.

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Preface

The National Network of Grantmakers (NNG) is pleased to publish Perry Mehrling's cogent report on foundation grants payout, a topic of great importance to the field of philanthropy. We commissioned Professor Mehrling, Chair of the Barnard College Economics Department and a member of the Columbia University faculty, to undertake this economic study as a non-biased expert. Mehrling's research is primarily a trends analysis of assets and grants since 1975. His findings also offer a broader perspective on foundation growth — including investments, gifts, and new formations — painting a picture of the grantmaking world that is not as endowment-driven as is widely believed.

NNG has revived a debate concerning "payout," urging our colleagues to pay out more in grants that address today's pressing problems. After 30 years of legislatively mandated payout, it is clear that too many private foundations have adopted the minimum payout rate of 5% of assets as a de facto maximum, even during times of significant asset expansion. At NNG, we can only conclude that a huge and mostly invisible element of the philanthropic field is more concerned with investment banking than grantmaking. We are working to shift the focus of the payout debate from building assets and avoiding tax penalties, to increasing the amount of grants to communities in greatest need.

NNG's concern has been with how a majority of philanthropy frames the payout debate. With certain notable exceptions, the foundation community's focus is on investment returns, market fluctuations, and maximizing wealth, losing sight of why they and the payout debate exist – the grantees. Grants are the primary way philanthropy impacts our society. Grants fund the people and organizations at the heart of building communities, alleviating poverty and creating change.

We initially asked Professor Mehrling to review the report of DeMarche Associates (1995), examine their assumptions, and run his own simulations. He found the DeMarche approach to be flawed. In addition to treating the hypothetical single foundation as the subject of analysis, DeMarche and others (Salamon and Voytek 1989, Salamon 1991,) ignore the possibility that the value and consequence of current grantmaking in solving urgent problems may well be higher now than in the future (Frumkin 1998). Mehrling's research is largely based on actual foundation grants payout and growth using the Foundation Center's data.

The subject of payout is controversial and methodologically challenging, and even the word payout is open to various interpretations. For example, the tax code uses the legal language "distribution requirement" and "qualifying distributions," which also include foundations' administrative expenses, program related investments, and trustee fees, in addition to grants. While some discussions of payout are in the context of the legally mandated distribution requirement, this report centers specifically on grants payout, or grants given out as a percentage of assets. Mehrling's focus is not the extent to which foundations can minimize their current charitable distributions to avoid being penalized.

Any study of payout trends needs to address the contested definition of payout and the quality of available data. There is simply no set formula for calculating the payout rates of private and other foundations. The IRS Statistics of Income (SOI) division in their SOI Bulletin looks at qualifying distributions as a percentage of investment assets from the same

year, but also includes accumulated "carry-over"(or past distributions in excess of 5%) in their formula. The Council on Foundations' *Foundation Management Series, Ninth Edition* (1998) model the SOI calculation, adding "total taxes paid." Salamon and Voytek (1989) and Salamon (1991) also look at "qualifying distributions" as a percentage of "investment assets" for the same year, but do not add in carry-over or total taxes paid. Instead they argue that payout should be computed on a multi-year basis. Complicating variables include the excise tax and the window of time allowed to meet the distribution requirement.

In fact, the Foundation Center's (FC) published data do not include all the variables needed for calculating legal distribution requirements. However, the FC does provide published aggregate data on foundation assets, grants and gifts since the 1970s. Without sifting through the hundreds of thousands of 990-PFs filed over the past three decades, this was the most readily accessible data, however limited. Published FC data are not disaggregated by foundation type and size for the full period under consideration. We do know from other studies, however, that a generally higher rate of giving by smaller and mid-sized foundations has compensated for the payout rates of the largest funders (Salamon and Voytek 1989, Salamon 1991, Arnsberger 1998-9).

For more than two decades, NNG has promoted strategic funding for social change. Social change giving is about reaching those that traditional charities often ignore, but who are in the greatest need of help — low-income women and children, the elderly, those with disabilities, and the poor in general. A premise of social change funding is that the disenfranchised, including people of color, lesbians and gays, can solve their own problems if they have the power and opportunity to do so. NNG works primarily within organized philanthropy to increase financial and other resources to groups committed to our vision.

Since 1997, NNG has focused more sharply on "moving" more philanthropic dollars to the causes that help make our world better, fairer, safer, more just and more sustainable for all people. Our survey of social change giving in the United States found that just 2.4% of all grantmaking addressed disadvantaged, disenfranchised communities in need. Furthermore, the Center on Budget and Policy Priorities reports that the U.S. now has the widest gap between rich and poor of any industrialized country in the world. If we are to see an increase in funding to those who are helping to change these circumstances, foundation grants payout is a logical place to begin.

This year, NNG instituted a new initiative "1% More for Democracy." We are asking our members to commit to increase their institution's payout rate – in grants only — by at least 1% over the legally mandated 5%. We call upon our colleagues in the philanthropic community to join this effort by increasing their payout rate to include "1% More for Democracy" to support social and economic change. The findings of this report clearly justify this call for an increase, and an immediate re-evaluation of the principles of American philanthropy.

—Teresa Odendahl, Ph.D.
Executive Director, NNG
September, 1999

Executive Summary

Payout by private foundations and public charities is the source of funds from which flow the grants that support much of the nonprofit activity in our society. Other things equal, higher payout means higher grants, and higher grants mean more nonprofit activity.

Under current IRS rules, private foundations are required to distribute yearly a minimum of 5% of their net investment assets as payout. Payout is not limited to a foundation's grantmaking; it may include administrative expenses, program-related investments, amounts set aside for future charitable projects, and trustees fees.

The concept of a legally-mandated payout was instituted by Congress in the Tax Reform Act of 1969. Initially, foundations had to pay whichever was greater — either all their investment return, or 6% of net investment assets. Revisions made to the IRS rules in 1981 set the minimum payout rate at 5% of net assets, where it has remained ever since. The context for the 1981 rule change was the previous decade during which payout had exceeded asset returns, with a resulting erosion of foundation endowments.

In the nearly two decades since then, asset returns have generally exceeded the minimum payout level, and a record amount of new giving to philanthropic institutions has completely altered the payout context. While Congress has not yet revisited the issue of whether 5% may now be too low, we can be sure that it will eventually. What would be the economic rationale for such a shift in policy?

- **Congress Has Achieved Its Goal:** The 1981 regulations that relaxed the minimum payout rate to 5% were intended to help private foundations rebuild their endowments, or corpus. Total foundation assets have grown in real terms by almost three times since then. Rebuilding has long since been completed.

- **Grants Payout at Lowest Rate in 20 Years:** During that same period of growth and rebuilding, foundation grants payout declined from 8% in 1981 to below 5% in 1997. Many foundations clearly have adopted the legally mandated 5% minimum payout rate as a de facto maximum rate.

- **The Rate of Gifts Received Has Created a New Dynamic in Philanthropy:** Contrary to expectations in 1981, the goal of increasing foundation assets and grantmaking capacity in line with economic growth has been met almost entirely by new foundation creation and gifts into existing foundations (84.5% of the increase), not by reinvestment of earnings on existing assets. This historical pattern looks likely to continue in the foreseeable future. A forthcoming report from the Boston College Social Welfare Research Institute estimates that intergenerational wealth transfer over the next 50 years will be substantially larger than

the previously estimated $10.4 trillion, providing an enormous source of new wealth for philanthropic institutions and nonprofits.

- **Foundations Could Give Out More and Maintain Corpus:** Proponents of the payout status quo often cite findings of a study conducted in 1990 by DeMarche Associates, CFA, and updated in 1995 by Carter Harrison, Jr., CFA, which concluded in favor of maintaining the 5% payout rate. Applying DeMarche/Harrison's methodology to the 20 year period 1974-1995, Table 3 shows that a typical foundation could have afforded a grants payout rate as high as 8% without reducing its corpus. This study refutes the methodology of the DeMarche study, however, and looks at foundation assets for the larger purpose of social policy rather than wealth maximization.

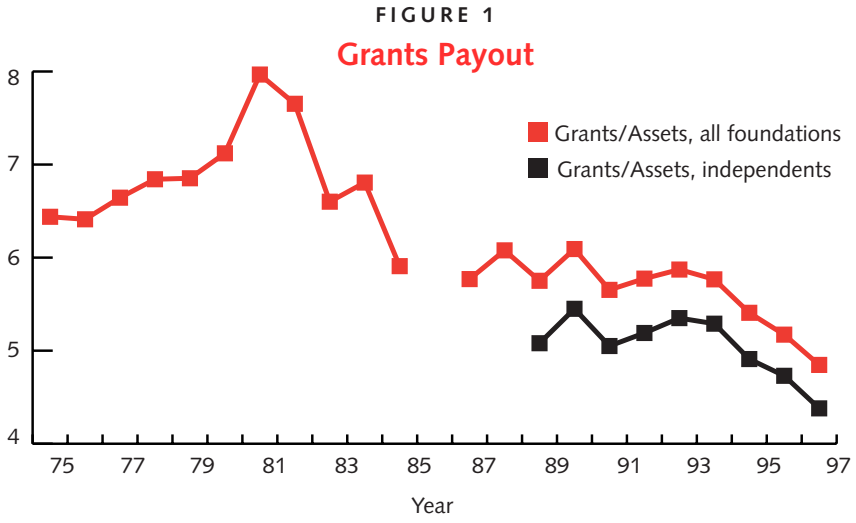
- **It is Time for a Change:** While clearly intending to help foundations with the 1981 payout regulations, Congress also required a minimum payout rate to prevent tax-advantaged foundations from becoming sterile warehouses of wealth. Unfortunately, that is exactly what has happened, due to the extraordinary investment returns and rates of new giving into new and existing foundations, combined with declining grants payout rates. The legislated 5% minimum payout rate has served to suppress grants payout at a time of growing need in our society.

The conclusion is compelling: a minimum payout rate of 5% may have been right for 1981, but it is too low for today.

Spending Policies for Foundations

After 1981, when Congress relaxed payout[1] requirements to a minimum 5% of net investment assets, the ratio of grants payout to assets for the universe of foundations fell precipitously from about 8% in 1981 to about 6% by the end of the decade (see Figure 1). In recent years, the ratio has declined further, falling below 5% in 1997. Such a low grants payout ratio may still meet the letter of the law because grants are not the only "qualifying distribution" that meets the legal requirement, and because foundations are allowed to average over five years. The question is whether such a low grants payout ratio is economically sensible in 1999.

FIGURE 1



Source: Foundation Center, *Foundation Giving, 1998*, Tables 9 and 10; "Highlights of the Foundation Center's *Foundation Giving*, 1999 Edition". The Foundation Center provides published aggregate data on all private foundations back to 1975. Data on independent foundations is taken from *Foundation Giving*, 1991-1999 editions.

The aggregate figures on grants payout are subject to the criticism that the universe of foundations is not a homogeneous group. Independent foundations account for the overwhelming majority of total foundation assets and grants. Although this group includes both large and small foundations with rather different payout practices, it is homogeneous in the sense that it is the most prominent group to which the 5% minimum payout requirement applies. Of more concern are the corporate, community, and operating foundations which together account for about 15% of assets

1. The term 'payout' includes all qualifying distributions—grants, administrative expenses such as rent and salaries, program related investments, amounts set aside for future charitable projects, and trustee fees. The term 'grants payout' includes only grants and excludes all other qualifying distributions. The analysis that follows is mainly concerned with the ratio of grants to assets, which is the significant figure from an economic point of view. This economic payout ratio concept should not be confused with the legal payout ratio concept, which involves total qualifying distributions divided by average assets over the previous five year period.

and 25% of grants. Does inclusion of these different groups in the aggregate numbers account for the aggregate trend? It is not possible to say for certain, because disaggregated data is available from the Foundation Center only since 1989, but the available data show that grants payout for independent foundations tracks the aggregate numbers fairly closely (see Figure 1).

TABLE 1

Disaggregation Analysis
Grants Payout Trends, 1989-1997

	Independent	Corporate	Community	Operating	Total
1989 Assets (%)	85.8	4.2	4.4	5.7	100
1997 Assets (%)	85.7	3.3	6.0	5.1	100
1989 Grants (%)	75.7	17.3	5.4	1.6	100
1997 Grants (%)	77.4	13.0	7.5	2.2	100
1989 Grants/Assets (%)	5.08	23.9	7.1	1.6	5.75
1997 Grants/Assets (%)	4.38	19.0	6.1	2.1	4.85

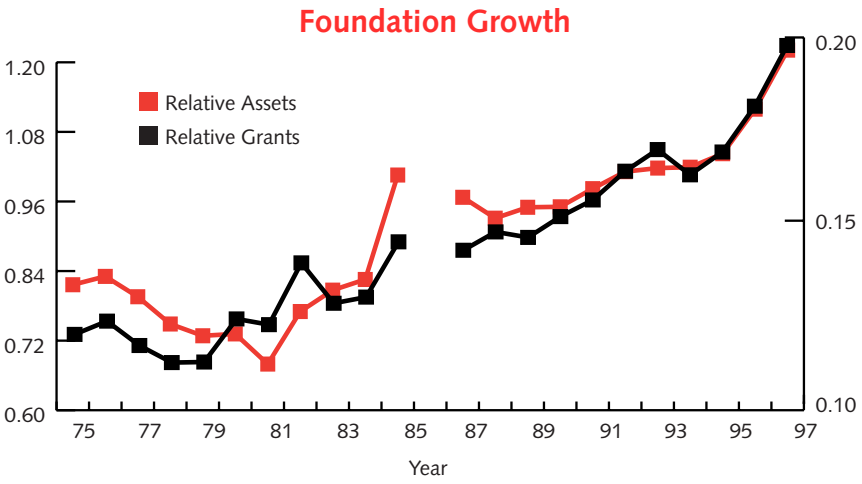
Source: Foundation Center, *Foundation Giving*, 1991-1999 editions.

Table 1 allows us to assess the potential bias involved in an aggregative analysis. It is clear that inclusion of corporate and community foundations tends to raise the aggregate grants payout ratio, because these subcategories have higher grants payout than the independent foundations. Balancing this effect somewhat, inclusion of operating foundations tends to lower the aggregate grants payout ratio. Another concern is that changes over time in the relative size of the different categories, as well as changes over time in the grants payout ratio within each category, may affect aggregate trends. In this respect, inclusion of corporate foundations tends to exacerbate the measured decline in grants payout, since corporate foundations were relatively larger and had higher grants payout in 1989 than in 1997. Balancing this effect somewhat, inclusion of the community and operating foundations tends to reduce the measured decline in grants payout. The overall effect can be assessed by comparing the aggregate decline from 5.75% to 4.85% with the decline for independent foundations only from 5.08% to 4.38%. Disaggregation changes absolute magnitudes somewhat but it does not change the overall trend.

Foundation Growth

Since 1981, foundation assets and grants have grown strongly, both in absolute terms and relative to relevant benchmarks. Figure 2 charts that growth by following the ratio of total foundation assets to financial assets of households and nonprofit organizations, and the ratio of total grants to gross domestic product. Note that the two series are plotted on different vertical scales. Both series show steady growth since 1981, accelerating somewhat since 1995. Both grants and assets have increased, but assets have increased faster, which accounts for the falling ratio of grants payout to assets.

FIGURE 2



Source: Foundation Center, *Foundation Giving*, 1998, Tables 9 and 10; "Highlights of the Foundation Center's *Foundation Giving*, 1999 Edition". Board of Governors of the Federal Reserve, Table B.100 "Balance Sheet of Households and Nonprofit Organizations". *Economic Report of the President 1999*, Table B-1 "Gross domestic product, 1959-98".

It is helpful to put these numbers in longer historical perspective. Nelson (1987, Table 5-2, p. 130) reports comparable figures for the more limited universe of private foundations between 1962 and 1981. Over that period, relative assets fell from 1.16% to .86%, and relative grants from .107% to .087%.[2] Over the same period, the ratio of grants to assets rose from 4.8% to 6.1% (Table 5-1, p. 129). This is the context that Congress had in mind in 1981 when it reduced required payout to 5%, a context that is almost exactly opposite the current one.

It is tempting to read the record of the last two decades as a vindication of the lowered payout ratio, but a closer look at the source of asset growth makes clear that the lowered payout ratio had very little to do with it. Table 2 shows that almost all of the increase in foundation assets has come from new gifts into new and existing foundations, and very little from returns on existing assets in excess of payout. (See footnote 3 for details about how the calculation was done.) New gifts accounted for 84.5% of the increase, while net increase of existing assets accounted for only 15.5%. Put another way, of the 5.81% average annual real asset growth over this period, fully 4.36% was accounted for by new gifts received, and only 1.38% by increase of existing assets.[3]

2. Nelson compares grants to gross national product, rather than gross domestic product.

3. Following Nelson, "internal growth" from investment return in excess of payout is calculated by first stripping out from 1996 assets all the new gifts over the entire period (50.98 billion), leaving 40.77 billion as an estimate of what 1996 assets would have been without any new gifts at all. (This is probably an overestimate, since the new gifts also compounded during the period.) The no-gift 1996 asset estimate is then compared with the initial 1977 assets (31.4 billion) to calculate the rate of compound growth, which is 1.38% annually. (This is probably also an overestimate.) "External growth" is then calculated as the additional asset growth from new gifts that is required to add up to the

Continues

TABLE 2

Investment and Gifts Foundation Growth Rate Components Total Foundations, 1977-1996

Constant 1975 Dollars, in billions

1996 assets including those received in 1978-1996	91.75
New gifts received in 1978-1996	50.98
1996 assets excluding those received in 1978-1996	40.77
Increase of 1977 assets net of payout	9.37
1977 assets	31.4
Annual asset growth, 1977-1996	
Total growth	5.81%
Gifts and new foundation formation	4.36%
Investment return net of payout	1.38%

Source: *Foundation Giving*, 1998. The Foundation Center's figures for gifts received begin only in 1978. Figures for gifts received in 1986 were not available, which biases the figures toward an underestimate of the importance of new gifts received.

Congress intended that the 5% minimum payout requirement would give foundations the opportunity to rebuild and foundations did so at the rate of 1.38% annually. What Congress did not anticipate was that new gifts would be so strong as to swamp the contribution of internal return. Two decades later, it is clear that foundation assets would have grown strongly even if payout had been 1% higher, and this historical pattern appears likely to continue into the foreseeable future.

Perpetuity and Payout: The individual foundation

Recognizing that there is no longer a case for keeping payout low in order to rebuild foundation assets, those who favor limiting payout to 5% focus instead on maintaining existing assets whole in the face of uncertain future asset returns. The most prominent such analysis is that of DeMarche Associates (1995). Their analysis differs from the preceding by its focus on the experience of a hypothetical single foundation with a typical asset mix of stocks and bonds instead of on the actual experience of the entire universe of foundations. For the sake of comparison, Table 3 shows the results of their alternative methodology when applied to the last twenty years.[4] If anything, the results are even more supportive of the conclusion that there is room for increased payout. Even an 8% charitable payout (which is 8.5%

3. ***(continued from page 7)*** actual total compound growth of 5.81%, so 1.0138x1.0436=1.0581. Because this calculation tends to overestimate the contribution of internal investment return, it also tends to underestimate the contribution of new gifts.

It should be noted that, although the calculation methodology is identical to Nelson's, the data to which it is applied here is somewhat different. He studied the growth of a fixed panel of foundations, while the present analysis is concerned with the growth of the foundation sector as a whole.

total payout allowing .5% for investment expenses) would have maintained the real asset value of the hypothetical foundation's endowment. Note also that total charitable payout over the twenty year period would have been higher with 8% payout than with 5%.[5]

TABLE 3

Summary Analysis of Different Charitable Payout Scenarios, 1975-1994 (in thousands of dollars)

	Charitable Payout			
	5.0%	6.0%	7.0%	8.0%
1975 Asset Value	1000	1000	1000	1000
1994 Nominal Asset Value	5058	4510	3778	3160
1994 Real Asset Value	1750	1453	1204	996
Average Asset Growth Rate	2.8%	1.9%	.9%	0%
1975 Charitable Payout	50	60	70	80
1994 Charitable Payout	269	271	264	253
1975-1994 Total Payout	2866	3082	3226	3314

Source: DeMarche Associates (1995, Tables 3-5) and author's calculations. All calculations include .5% investment management expense in addition to charitable payout.

It should be noted that the figures in Table 3 depend on the time period, which was chosen to match as closely as possible the time period for which the aggregative Foundation Center data is available. DeMarche Associates conduct their analysis for the longer period 1950-1994, and find that 5.0% payout results in asset growth of 25.4% over the whole period, which is about .5% annually, so their analysis supports a payout increase of .5%. Craig (1999) conducts a similar analysis for the period 1900-1999, and finds that 5% payout results in asset growth of 0% (after subtracting .7% for investment expenses). Since there is no particular reason to think that the distant past provides better information about the future than does the recent past, there is no particular reason to prefer their figures over those in Table 3. The plain fact of the matter is that we don't know what future asset returns are going to be.

What is the right policy for a foundation facing uncertain future asset returns? Modern finance teaches us that the right policy for an individual wealth holder depends on her degree of risk aversion. The DeMarche and Craig analyses both draw an analogy between the individual wealth holder and the individual foundation. That analogy is arguably strained, however, since it is questionable whether the foundation is or should be a risk averse

4. To ensure comparability, investment returns were taken from DeMarche Associates (1995, Tables 3-5) which explains why the most recent year is 1994. In order to retain a twenty year time span, the start date was pushed back to 1975. Because of the different time spans, Tables 2 and 3 are not strictly comparable.

5. Figures for total charitable payout are provided for the sake of comparability with DeMarche Associates, Table E-1. From an economic point of view, however, it is not legitimate to add payouts in different years without discounting later years by the time value of money.

wealth maximizer. A better analogy is that between a profit-maximizing firm and the foundation.

A foundation is like a firm that mobilizes its assets in order to maximize profit, but with profit conceived more broadly. An ordinary firm makes an investment when the expected benefit is greater than the expected cost and, since both these numbers are naturally expressed in monetary units, the required comparison is relatively easy and the decision is straightforward, at least in principle. For a foundation, things are not so easy because the relevant benefits and costs are not always naturally expressed in monetary units, nor can monetary values always be easily deduced. Nevertheless, the principle is clear. Just like a firm, the goal of a foundation should be to make a "difference" (or some other analogue to the private firm's "profit"), not to perpetuate itself as an entity.

In the world of firms and profit, there are checks that prevent firms from losing sight of their legitimate goals, checks such as takeovers and bankruptcies. The only analogous check in the world of foundations is the 5% minimum payout which, as we have seen, is a rather weak check. The analogy with profit-maximizing firms suggests that payout rates should be high enough that foundations are required to attract new funds in order to pursue their missions. Foundations that do not want to become sterile warehouses of wealth should adopt higher payout rates voluntarily.

From this point of view, the methodology employed by DeMarche/Harrison and applied in Table 3 is irrelevant, since perpetuity in itself is no legitimate goal of a charitable foundation, nor are the conservative spending and investment policies that follow from adoption of such a goal. As used in this study, Table 3 can be seen as a bridge between the narrow, individual approach used in DeMarche/Harrison and the broader social approach adopted below.

Perpetuity and Payout: The foundation sector

Behind much of current debate about payout rates one senses a concern not just to ensure that grantmaking capacity doesn't shrink but even more to ensure that grantmaking capacity grows at least at the rate of growth of the economy, if not faster. However compelling are today's social problems, tomorrow's are likely to be just as compelling, and also likely more expensive given the increasing scale of economic activity. From the point of view of an individual foundation with a fixed endowment, it appears that the only thing it can do to prepare for the future is to set aside some of today's investment return, which means keeping total payout below return. This is the point of view that lies behind much of the resistance to higher payout rates.

From a larger point of view, however, growth of grantmaking capacity depends very little on reinvestment of returns from existing assets, and much more on new giving to existing foundations and on new giving to

form new foundations. The historical facts on this matter (see Table 2) are incontrovertible. From the point of view of society as a whole, it is not the asset growth of any individual foundation that matters, but rather the asset growth of the entire collection of foundations. From a social point of view, the collection of foundations appears as one large unified foundation whose assets have grown at 5.81% annually over the last twenty years, which is significantly faster than the rate of growth of the economy.

From a social point of view, even the asset growth of the entire collection of foundations underestimates aggregate grantmaking capacity. What matters is the growth of the total quantity of assets devoted to charitable purposes and the income generated by those assets, whether or not those assets currently reside in a foundation endowment and whether or not that income is channeled through a recognized foundation entity. Classification as a charitable foundation is a tax status, and nothing more. If tax law were changed to favor segregation of charitable assets into legal entities called foundations, then foundation assets would grow, but that doesn't mean that charitable assets would grow.

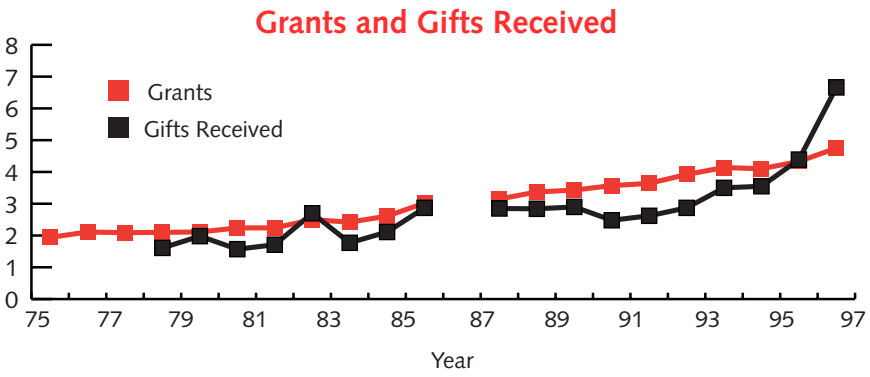
To make the point completely clear, it will help to have in mind the difference between two idealized charitable giving systems, an **endowment system** and a **non-endowment system**. In an endowment system, foundations own all charitable assets, and all grants are funded from the income on those assets. In a non-endowment system, foundations hold no assets and all grants are funded by new giving that flows into foundations from the income generated by charitable assets held elsewhere. Note that in a non-endowment system, it makes no sense to calculate a payout ratio for an individual foundation, since foundation assets in the denominator of such a ratio are zero. Note further that, though the two systems look very different, total grants will be the same so long as total charitable assets are the same in each system.

Which of these systems best describes the U.S. charitable giving system? The attention paid to payout ratios suggests that people think of the U.S. system as an endowment system, but is it? Not when you take an aggregative point of view. Figure 3 shows that over the last two decades new foundation creation and gifts into existing foundations has been approximately the same order of magnitude as total foundation grants. Summing over the period 1978-1996, new gifts received was 50.98 billion (in constant 1975 dollars) while total grants were 57.64 billion. This is the pattern one would expect to observe in a non-endowment system in which all gifts received are spent on current grants. Figure 3 shows that, in effect, the entire foundation sector has been behaving as though it were a non-endowment pass-through foundation, spending current giving and leaving existing assets almost untouched.

To the extent that the U.S. charitable system is a non-endowment system, it makes no sense to limit total payout to only 5% of whatever assets hap-

pen to be on foundation balance sheets at a moment in time. Furthermore, and also to the extent that the U.S. charitable system is a non-endowment system, measured payout ratios are much less relevant to the question of perpetuity than is commonly realized.

FIGURE 3



Source: Foundation Center, *Foundation Giving, 1998*, Tables 9 and 10.

Conclusion

No one says that individual non-endowment foundations (for example, most corporate foundations), which necessarily have very high payout ratios, are by virtue of their high payout endangering the perpetuation of their charitable mission. The reason no one says this is that it is apparent that there are perfectly adequate assets generating the payout. They just happen to be on the balance sheet of the foundations' sponsors, not of the foundations themselves. By analogy, to the extent that the U.S. foundation sector operates as if it were a non-endowment system, the measured payout ratio has very little to do with the issue of perpetuation of the charitable mission of the foundation sector as a whole.

The impetus for the current discussion about increasing payout (see Odendahl 1999 and Craig 1999) is, no doubt, the strength of recent asset returns. From an economic point of view, the true importance of recent asset returns is that they have swelled the volume of charitable assets held outside current foundation management. It is these assets, not the investment return net of payout on existing foundation assets, on which perpetuation of the charitable mission of the foundation sector depends.

Finally, it needs to be remembered that the 5% minimum payout requirement imposed by Congress is there not to keep foundations from paying out too much but to keep them from paying out too little. Putting the point more sharply, Congress intended to keep tax-favored foundations from becoming mere warehouses of wealth. To the extent that the foundation sector operates as if though it were a non-endowment system, paying out new giving while allowing existing assets to compound in perpetuity, the foundation sector is in danger of appearing to be exactly what Congress

wanted to prevent (and probably still wants to prevent). To the extent that individual foundations reduce payout to the legal minimum simply in order to increase their assets under management, they defeat the real social purpose of their privileged tax status and risk attracting renewed legislative attention.

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